RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Dec. 17, 1997 **LETTER 1241**

Oops: I received half dozen Letters telling me that they hate the new format. Just proves that I can't please everybody, but I keep trying.

VOLATILITY: Most people are not aware of it, but the current divisor for the Dow is at an **historic low of 0.251.** This means that a one point change in any of the 30 Dow Industrials will move that average approximately **four points.** Let me give you an example -- if, on a given day, 29 of the 30 Dow Industrial stocks are unchanged and IBM alone rallies 5 points, the Dow will be up 20 points for the day.

YIELDS: The old, time-honored rule was that when the yield on the Dow sinks to 3% or less, stocks are no longer values. And historically, when the yield on the Dow dropped to 3%, a bull market was ready to top out. But that was then, and this is now. The current bull market has turned history on its ear. Currently, of the 30 Dow Industrials, only Phillip Morris (3.68%), GM (3.28%), and J. P. Morgan (3.08%) yield more than 3%. **The remaining 27 Dow stocks yield less than 3%** -- down to the three lowest yielders, which are McDonald's (0.68%), Wal-Mart (0.68%) and Disney (0.56%). My bet -- one day in the future you'll look at this paragraph, shake your head and say, "I just don't believe this ever happened."

Another Record: Never in history have we seen three successive years in which the Dow gained better than 20% each year. This year, for the third year in a row (unless the market collapses between now and the end of the year), we will have witnessed **three successive better-than-20% years.** But it wasn't easy. To break the old record, stocks in '97 had to advance to their highest valuations in history.

Question: Since 1895, the date of the first Dow Average, Wall Street has never seen three better-than-20% years in a row. How or why has it happened now?

My answer: It's happened because we've experienced a public demand for stocks beyond anything ever seen before in stock market history. The public is continuing to buy stocks to the tune of billions of dollars worth a week, a large portion through mutual funds. With average stock yields at record lows, it's obvious that the public is not buying stocks for income. They are buying stocks as a form of "savings" and in the unshakable belief that the market (with occasional jolts) will continue to head higher (thereby taking care of US investors in their old age).

So what we're experiencing is an unprecedented phenomenon in terms of public participation in the stock market. My concern is not that the bull market will end (for, obviously, somewhere ahead it will end) -- no, my concern is what happens to the nation and its stockholders when the bull market finally does end.

THE MARKET: I'm almost embarrassed to confess this, but yes, I keep asking myself -- is this bull market fated to continue or are we watching the most extended and complex top in stock market history? If you're an optimist you can simply sit back and repeat the classic Dow Theory thesis -- "The trend **continues** until proved otherwise. The **last confirmed trend was bullish,** and so far there's been no 'otherwise.' Therefore, the bull lives."

Dec. 5 DJIA 8149.13; PTI 5165; A-D Ratio +10.49
Dec. 12 DJIA 7838.30; PTI 5157; A-D Ratio +9.62
Dow Yield: 1.74%; Dow Price/Earnings: 20.2
Dow 144-day MA: 7678; Dow 34-day MA: 7854
Dow Times Book Value: 5.54; PTI 89-day MA: 5076
Percentage of Undervalued Blue-chips: 2%
Gold 34-day MA: 303

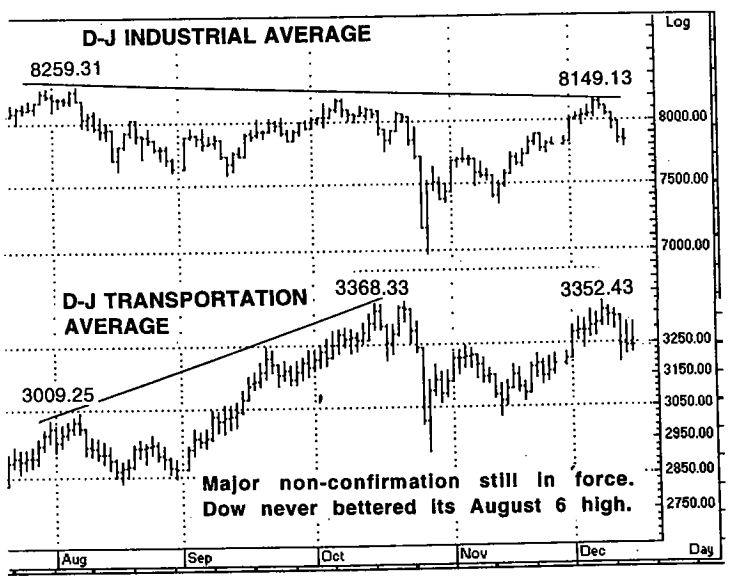
Further ammunition for the bulls occurred on November 25 when the **D-J Utility Average** closed at a record high. Then, on December 4, the **S&P 500 Composite** also closed at a record high.

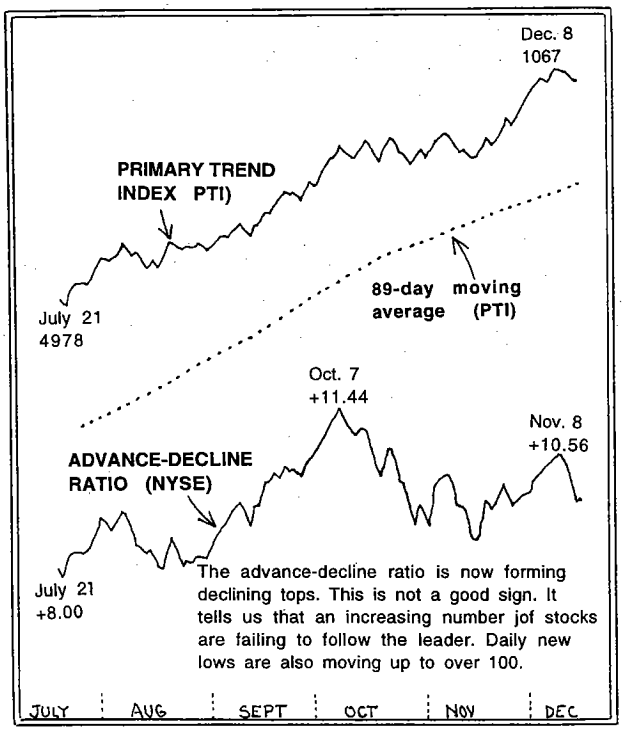
"That's great," you retort, "But what about the Dow? The Dow hasn't recorded a new high since August 6. That's a problem for the bulls. And the Transports have been strong, but they haven't rallied above their October 21 high."

"Yes," the bull answers, "admittedly, the Dow has been a laggard ever since early August. But if this is still a bull market, then it should be only a matter of time before we see new record highs in both the Dow and the Transports."

OK, but what if you're a skeptic or if you're just plain tired of watching overvalued stocks get more overvalued? Well, then you can argue, "Listen, it's been over four months since the Dow recorded its last high. Four months, a third of a year, that's a long time for the stock market to be bouncing around with the Dow failing to record a new high."

You can be stubborn and insist, "I'm from Missouri -- show me. If we're still in a primary bull market, show me -- I want to see the Dow advance to a new record high above **8259.31,** and I want to see the Transports confirm by rallying above **3368.33**. That's the action that will really convince me -- new highs in the two Averages. Yeah, I know about the new record high in the Utility and the S&Ps. But Dow Theory concerns itself with the Dow Jones Industrial Average and the Dow Jones Transportation Average, and **if it's a bull market both of those must go to new highs."**





PRIMARY TREND INDEX (PTI): In the meantime, my PTI is just off its high. The PTI is the index that has kept us on the **right side** of this market for months and even years on end -- through mini-crashes, through non-confirmations, through divergences, through Presidential scandals, through depressing Mideast news, and through the myriad warnings of bearish analysts.

I write a lot of words every other week, six pages of them in fine print -- and, like anyone else, I like to be right. But confession -- the PTI is smarter than I am (and it does possess one major advantage -- it's not affected by emotions). The PTI has been smarter than I am ever since 1971 when I first introduced it. So as for me, I won't turn bearish until I see the PTI in a definitive downtrend. I'm waiting.

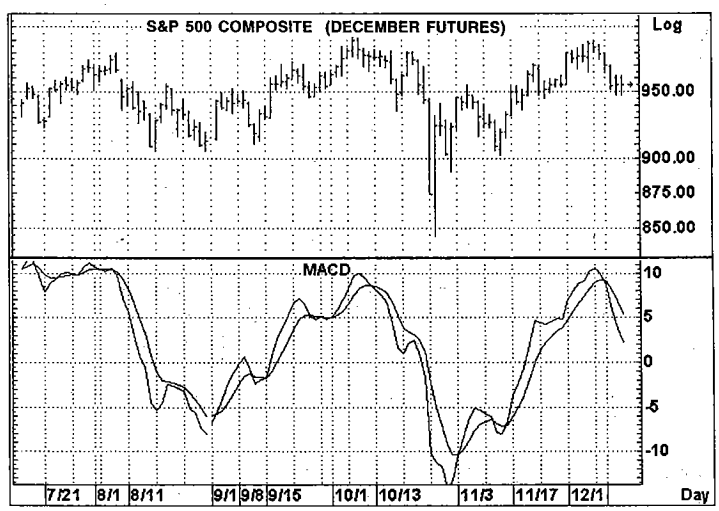
Selectivity: If you own a diversified portfolio of stocks you've probably noticed it. There's a lot of selectivity showing up in the stock market today. It shows up in the sagging patterns of many individual stocks and it shows in the advance-decline ratio, which has been lagging the major averages.

The fact is that many stocks now appear toppy, a lot of stocks are moving sideways, and a lot of stocks are heading down. These are characteristics of an aging bull market. The older the bull market, the more selectivity, the more stocks that fail to follow the leaders. **That phenomenon is seen in the lagging profile of the advance-decline ratio.**

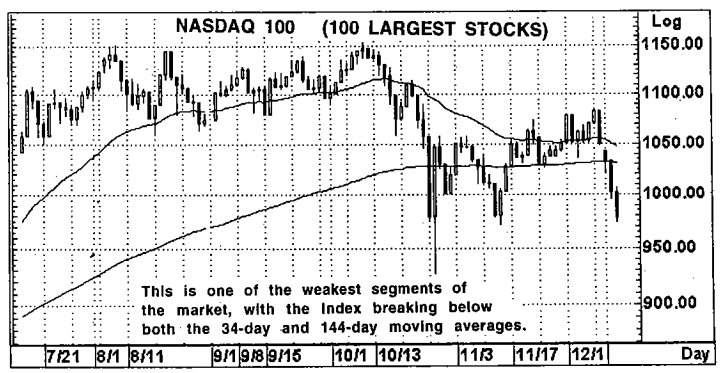
In a bull market, classically, the Dow tends to be the last of the Averages to run into trouble, the last to top out. Often we'll see a final high in the Dow, but that final high is not confirmed by the A-D ratio. So at this point I urge subscribers to watch the A-D ratio carefully (it is shown in every Letter on the page 2 chart).

Fed Dilemma: It's clear that were it not for the deflationary Asian mess, the Fed (with US wages rising and unemployment down to a low 4.6%) would be pushing up rates. How bad is the Asian situation? It's **worse** than the pessimists think. The Asian mentality is to avoid losing face. On top of that they are proud. So there's a reluctance to admit the depth of the crisis and a resistance to accepting money or restrictions from the IMF. What we're seeing is literally a meltdown in Asia, with their currencies, their stock markets and their economies caving in. Item: S. Korea lied about its foreign exchange reserves. Evidently it had lent them to cash-short banks that were unable to pay back their loans when the pressure hit. Japan has been reluctant to even admit their massive bank losses. **Russell opinion:** The bailouts will have to be far larger than what is now considered adequate. The crisis will take much longer to resolve than what is now expected. The Asian crisis will definitely have an impact on corporate earnings, and remember, the market is now factoring in high earnings for 1998.

Below are a few significant charts that are worth studying. The first chart shows the S&P futures, and MACD, the moving average convergence/divergence study. The MACD line is simply the difference between two moving averages. A second line, the "signal line," is a short-term moving average of the MACD. When the signal line crosses above or below the MACD line, we receive a buy or a sell signal. On December 10, the signal line dropped below the MACD line, rendering a **sell signal.** Furthermore, the sell signal came from a high level on the indices, suggesting that this sell signal could be an important one. Based on past history, the downtrend should last until MACD declines well into negative territory (note how low MACD dropped at the end of November).



The next chart shows the NASDAQ 100 Index, which contains a good many of the leading tech stocks. This index has now dropped below both the 34-day and the longer 144-day moving averages, and I think it is this Index almost more than anything else that has been getting on the stock market's "nerves."



A third item (not shown) is one that I consider a bellwether, Merrill Lynch, the largest of Wall Street's brokerage houses. Wall Street, itself, is extremely sensitive to coming financial trends and events. When good times loom, the brokerage stocks sense it and they head higher. When tough times are ahead, the brokers feel it via sliding commissions and their stocks head south. MER is still technically in an up-trend, although, significantly, on its most recent run-up MER failed to better its October 6 closing high of 77 26/32nds.

significant. Wall Street talks about the **"Asian Contagion."** Here's what the Contagion has done. Thailand's currency has declined 36% while its stock market is down 52%. Malaysia's currency has declined 28% while its stock market is down 56%. Indonesia's currency is down 35%; its stock market is down 37%. Philippines' currency is down 24%; its stock market is down 44%. S. Korea's currency -- down 27%; stock market -- down 37%. Japan's currency -- down 11%; market -- down, this year alone, 14%. Singapore's currency -- down 12%, market -- down 25%. Hong Kong's currency -- stable; stock market -- down 22%. Taiwan's currency -- down 14%; market -- down 12%. China's currency -- not convertible, but its stock market -- down 24%.

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I find it hard to believe that with **33% of the world's GDP slumping,** the US is not going to be affected. But clearly, the US market has shaken it off, so far, and is taking a very optimistic view of the global picture. I won't argue with the market, I never do. But I do remember the old adage which states, "The market always does what it's supposed to -- but never when."

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I've written about this before, but now it seems dramatic -- the growth rate of the **global population** is declining. More dramatic --among the developed nations the birth rate is actually below the replacement rate. These nations will actually be showing shrinking populations, and this is occurring in what history will judge as boom times. For instance, by the year 2060, when Europe's population levels off, it will have lost 24% of its people. Consider this -- Europe's birth rate of the 1980s, already at record lows, fell another 20% in the 1990s, to about 1.4 child per woman. It takes a birth rate of 2.1 child per woman for a population to even stand still. Amazingly, Italy, a Catholic nation, has a fertility rate of 1.2, lowest national rate ever recorded. In the US, birth rates have been below replacement rates for 25 years. Only immigration has boosted the total US population.

Why are women having fewer children? One reason is urbanization, which reflects the shift from farmers wanting more kids to help them to city dwellers, where more kids simply means more expensive mouths to feed. Other factors include more education for women, legal abortion, higher incomes, greater acceptance of homosexuality, empowerment for women, more divorces and vastly lower infant mortality rates (when women know their kids will survive they have fewer kids). Facts -- lowest US fertility rates occur among Jewish women and black women who are college educated. The largest concentration of people living alone? Manhattan, where 48% of the population lives alone. How about population trends in the undeveloped nations? Here too the growth rate is declining in many nations, and in some, the fertility rate has dropped below replacement levels (this includes China, Cuba, Thailand and soon Brazil).

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I said it before, and I'll say it again -- Las Vegas is overbuilding. There are just too many rooms in Vegas (furthermore, the crowds remind me too much of NYC, and the shows are no longer cheap). Now we hear that Sheldon Adelson is adding 6,000 rooms via his new hotel, the Venetian. This is angering the other Vegas hotel owners, but it's happening and construction is underway now. The financing for the Venetian is not something I'd buy into. Adelson is putting up almost no cash of his own, but he is contributing 63 acres of land. Goldman Sachs is lending the money: $425 million in first mortgage notes sold at 12.25% and an additional $90 million in subordinate debt was sold at (gulp) 14.25%. The 14.25% is about double what the other casinos have paid, giving the other casinos a substantial edge on profit margins.

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Speaking of Vegas and Nevada, my old pal, **Aaron Russo,** is running for governor of Nevada. Aaron is a very good man, he's for getting government off our backs, he's for individual rights, and he's always been a winner (as a Hollywood producer Aaron produced "Trading Places" with Eddie Murphy and "The Rose" with Bette Midler). If you live in Nevada (or anywhere else) support this man and send him **money.** Aaron is fearless, he's a doer, he's a fighter, he'll be good for the state, I know it. Aaron Russo for Governor, 4921 Wilbur St., Las Vegas, NV 89119.

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Danger: What do you know, the medical board of the state of Nevada is going to save its citizens from the "dangers" of chelation. Thousands die each year from cigarettes and alcohol-related accidents; why doesn't the medical board try to ban butts and alcohol? Well, because there's too much money involved. But chelation, who does it hurt? Well, it hurts physicians who would rather operate. By the way, the article mentions homeopaths. Who? Brace yourself -- many real, live, full-fledged physicians administer chelation treatments, and the cost is $80 to $90 a session. Another secret -- many physicians (secretly) take chelation treatments, some self-administered.

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Coming back from a chelation session, I drove through Pacific Beach, part of which is very "hippie" almost reminiscent of the '60s. I stopped to have an early dinner at Tokyo House on Garnet Avenue. There you get a bowl of delicious miso soup (with refill if you wish), and a huge platter of chicken, rice, salad and spiced noodles and all for $4.25 (before 5PM). You have trouble finishing it all -- bonus, you can sit at the window and survey the passing scene of long-haired hippie girls, tattooed men, and motorcycle riders. After dinner I crossed the street to my car, then stopped at the Birkenstock shoe window. I've always wondered about these weird looking, German-made shoes, and with time on my hands I popped into the store. The manager was a "flower child" straight out of Woodstock. He showed me the line of shoes, and after trying on a dozen pairs, I zeroed in on the sandals. I have lousy feet, they hurt a lot, and my arches have fallen. I tried on a few sets of sandals, and the flower-boy informed me that it was important that "I develop a relationship with the shoes." Well, I've worn the Birkenstocks for a few days, and darned if my feet don't feel a lot better. Hard to believe. I tossed out my expensive Orthopedics (prescribed by a podiatrist), and now I'm a Birkenstock fan. Yes, they're kinda ugly, but they feel great and I'm busy working on a relationship with my sandals. Try the "Birkies," they're weird, they're well-made, they feel great.

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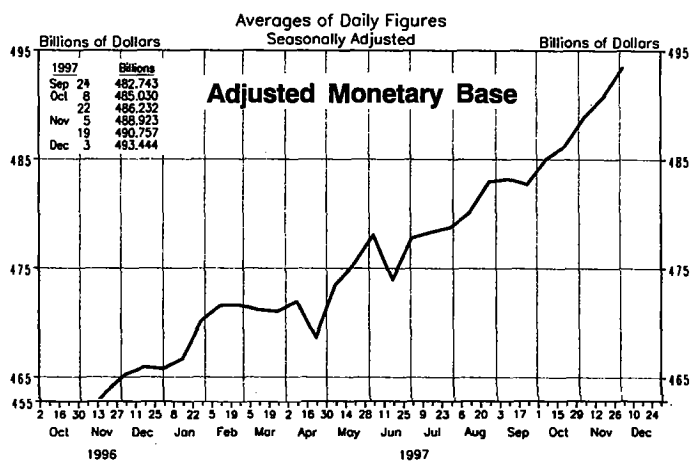
It isn't what they say, it's what they do. This chart, courtesy of the St. Louis Fed, shows the relentless upward climb of the Adjusted Monetary Base. The Base has been climbing over recent years, but over the last two months it's been surging at a compounded annualized rate of **11.6%**. This tells me that the Fed is worried about the deflationary potential of a collapsing Asia and is offsetting world deflationary tendencies by "pressing the pedal" to the US monetary base.

Actually, there are a lot of arguments regarding inflation vs. deflation. Classic deflation is a situation (this happened in the '30s) when the money supply is shrinking, and when there just isn't enough money available to buy the goods being offered. Result: the price of goods goes down. But there's another kind of deflation, a deflation of goods. This occurs when extremely competitive conditions prevail. We can see this today, for instance, in computers and in TV sets. These items have been deflating in price simply because a lot of manufacturers are in vicious competition with each other.



But it's still a tough call -- economists within the same brokerage houses disagree on the outlook, with some predicting inflation while others are forecasting deflation. As for deflation, my old friend Jim Grant (of *Grant's Interest Rate Observer* fame) remarks, "A deflation can be quite hospitable for a cold-hearted person with a secure job and a lot of cash."

13D Research Inc. [(208)726-1565] makes a compelling case for **deflation.** Following are just a few of their most recent observations: "Utilities are at record highs, and utilities tend to lead bonds. US producer prices are down 0.3% from a year ago. Used car prices fell near 6% in the year ending Oct. 31. Raw materials in Canada have declined nearly 6% in the last 12 months. US service inflation has slowed to a 32-year low and, in the past three months, consumer goods prices have dropped at the fastest rate in history. UK prices have declined nearly 9% in the past 12 months. The Fed's weekly calculations of growth in personal bank loans show a decline of nearly 2.5% in the past 12 months. This series peaked at 16% growth in '94 and typically only turns negative in recessions. The year-over-year growth in US consumer installment debt has slowed from nearly 15% in '95 to a recent low of under 4%. The number of business failures has risen sharply in the past year and is approaching the highs of the early 1990s. Bankruptcies are at all-time highs. Retail sales fell unexpectedly in October for the second month in a row. Government spending of G-7 nations continues to slow. During the second quarter such spending grew only 1.4% year-over-year, a record low. US layoffs are on the rise again. The combined broad money supply of 65 countries has been slowing sharply. After peaking in the high teens in '96, global M3 growth has fallen to near zero." **Russell comment:** All of the above is deflationary and basically bullish for bonds.

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The US is now the only locomotive of global expansion. The Fed would probably welcome an even stronger dollar with an accompanying surge of $100 billion in high-grade Asian imports, events that would **reduce inflationary pressures** on the current US economy. However, the same would hardly please US labor, which is pushing for higher wages, nor would it please Detroit, which already feels the squeeze of cheap foreign auto imports.

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The collapsing S. Korean won will put additional pressure on both Japan and China. If the pressure becomes intense (and I think it will) China will cut interest rates and devalue again. This could set off another whole round of Asian devaluations -- with the dollar and the European currencies starting to look very expensive.

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My wife, Faye, has a copy of the book, entitled, **"The Art of War,"** written 2,000 years ago by famed military strategist, Sun Tzu. Tzu was an advocate of winning without fighting, but when all else failed, war was necessary. The best method, said Sun, was to "attack an enemy's plans," and the next best was to disrupt his alliances, for "to subdue the enemy's army without fighting is the peak of skill." Or we might put it this way: "When the enemy advances, we retreat. When the enemy halts, we move forward. When the enemy seeks to avoid battle, we engage. When the enemy retreats, we pursue." It's obvious that consciously or unconsciously Saddam understands all this. Saddam has splintered the alliance, he's rendered Clinton a chump resorting to never-acted-on threats. And you know what -- Saddam is winning.

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After being a **pro football** fan for decades, I've finally turned off on the "sport" (yeah, even though the Super Bowl will be in San Diego this year). The officiating in pro football is ridiculous, and huge mistakes are made, mistakes which have definitely decided the outcome of games. With only 16 games in pre-season, how can the NFL justify not bringing back "instant replay"? They justify it because instant replay "slows the game" -- so it's obvious that pro football is basically a money-making spectacle, not an honest sport (if it was an honest sport, they would demand real, honest officiating minus all those mis-calls). Furthermore, a winning team often loses its top starters the following year to free agency. Or gee, your favorite team may just pick up and move to another city, a city that gives them a better deal or a better stadium. The Tennessee Oilers, who are they? The Raiders back in Oakland, for how long? Nah, I'll read a book instead. Or I'll watch an honest sport like track or water polo. **Oddity:** the Raiders have a collection of **18 first-round draft picks** (many they picked up on trades or as free agents), and they are having a lousy season. What does it take?

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I've been around a while, and I've paid taxes for a while, a long while. But today I pay a heck of a lot more taxes, percentage-wise, than I used to. And the maddening thing is that I don't feel the government is doing any more for me today than it did 50 years ago. I take that back, the government is more intrusive and a lot more annoying now than it was 50 years ago.

It's lucky that I like my work, because half of the fruits of my work goes to the government or the state or some other damn agency. The fact is that I'm spending half my time working to pay federal income taxes, federal payroll taxes, federal self-employed taxes, state sales taxes, property taxes, gasoline taxes, utility taxes, plus fees and licenses and levies. It's disgusting and it's demoralizing. No wonder the guy who owned my favorite Chinese restaurant just packed it in and moved back to Hong Kong.

There no question that a small portion of the US population has become very rich during the '90s, and an even smaller percentage has become fabulously rich. But ironically, this year around 1.3 million people will file for personal bankruptcy. They've either borrowed over their heads or they've lost their jobs or who knows -- the fact is that they just couldn't make it. And this is in boom times. With high taxes and a wish to live the good life, Americans are now working harder than ever. Families with both husband and wife working full time are now commonplace. It's the kids that suffer in the new prosperous era of the '90s.

So what's it all about? It's about the chase for the good life, the 45-inch TV set, the house that you actually own (the heck with rent), the big modern bathroom, the vintage wine, the upscale restaurant, and maybe going to a Saturday night movie at eight bucks a pop. Does it make sense? Who knows, it's modern life. And you better love your work, because it's no treat working your fanny off for long hours, just to keep our government and all its crazy agencies in business.

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There are two conflicting philosophies today, one says, "die rich," and the other says, "die broke." A book, "Die Broke," by Pollan and Levine, is a best-seller. Another by Barry Kaye is called, "Die Rich and Tax Free." Kaye does a lot of advertising, and he's also an insurance salesman. Here's his secret -- if you buy a ton of insurance you'll die rich, the only problem is paying those premiums.

Personally, I'd prefer to die without too much money. I'm not saying I want to die "broke," because I can't cut it that fine. But I'm not a big spender, I've always been a saver, and I feel that the best deal today is to give away 10 grand annually to whomever you want. The government says you can give away 10 grand each year to as many people as you want, and if you're a couple you can give away twice that much -- $20,000. All that money that you give away as gifts reduces the size of your estate, so actually you can give away all of your money and when you die the government and state won't have a lot to tax.

Of course, there's a trade-off. If you like power or safety, you won't want to give away too much of your gelt. But the other side of the coin is that if you give away your money while you're alive, you have the pleasure of seeing that it does somebody else some good. As I said, I prefer the giving-away method, but that's just me. One die-broke fan put it this way -- "The last check you write out should be to the undertaker -- and it should bounce."

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Speaking of money, the estimate is that the Gross Domestic Product of the entire world runs to around $24 trillion. Of this, the Asian portion is about $8 trillion or one-third of the world GDP. Now that Asia is slumping the figures become particularly

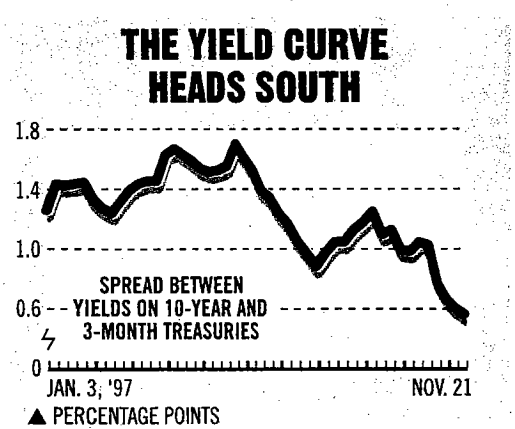
BONDS, RATES, INFLATION: This chart, courtesy of Ed Hyman's *ISI*, traces long bond **yields** going back to the late 1960s. Bonds were in a **bear market** right up to 1980, and during that period bond yields rose accordingly. The chart identifies many "emergencies" or panics in the financial markets. Note that each panic produced a spike in bond yields.

It is important to note that during the period up to 1980 each spike was followed by even higher bond yields. This is characteristic of a bear market in bonds (in other words, the long-term direction of bond prices was down, while at the same time the direction of rates was up).

This syndrome ended in 1980. In 1980, a **major bond bull market started.** Note that following 1980, the action following each emergency spike was very different; now each spike was followed by **declining bond yields.** All of which takes us to the present.

Here we see the Pacific Rim spike, followed by the most recent bond yield decline to the 6% level. If bond yields break below 6% and then below 5.8%, we will be seeing the lowest bond yields since the early '70s. All this would suggest dis-inflation and possibly a period of deflation (something no baby boomer or generation Xer has ever experienced).

YIELD SPREAD: This chart shows the yield spread between the 10-year note and the 91-day T-bill. The spread is now a very narrow half a point. This is a prediction of around 1-2% GDP growth, which is what many experts now predict. Normally, this narrowing spread is caused by the Fed pushing up short rates while the long rates hold relatively steady. But currently, the short rates have held very steady at around 5.27% while it is the long rates which have declined.



The explanation for the decline in the long rates has to do with the Asian situation. Bond buyers believe the Asian mess will slow the US economy (dis-inflation). They also feel that the strong dollar will hurt US exports, and again this will slow the US economy.

A decline in long rates with short rates holding last occurred during the second half of 1985 and early-1986 -- at that time most economists were predicting booming business. Actually, business slumped during the first quarter of '85 and the Fed had to lower rates four times to revive the sinking economy.

INVESTMENT POSITION: They say that the Japanese might sell part of their huge $300 billion in Treasury bonds. They say that despite the deflation in Asia, the US (with our M-3 money supply rising at a 10% rate) is in for inflation, and thus the bonds are heading for trouble. They tell me that too many advisors are advising bonds. They tell me, they tell me, they tell me, blah, blah, blah.

I tell them that with one-third (the Asian third) of the global economy in recession, this suggests to me that next year is going to have to contend with a huge negative trade balance. Next year is also going to see a flood of cheap Asian goods hitting the US shores. I tell them that this is deflationary, but that I understand that Americans don't even know the meaning of deflation.

At any rate, I've personally taken a pretty large position in T-bonds, bonds that mature in about 20-years or more (maturing in 2020 or thereabouts). I think I've got a few things going for me: **(1)** the deflationary and maybe dangerous Asian mess; **(2)** a very old bull market, that could top out; **(3)** the possibility of trouble coming out of the Mideast; **(4)** deflationary trends in commodities, copper, crude oil; **(5)** extremely optimistic expectations on the part of the public (contrary opinion might work here); **(6)** an immoral, unbelievably lucky president who might just run out of luck in '98; and **(7)** a need by the US for far fewer bonds than in previous years, due to the smaller government deficit.

NOTES & QUOTES: What does the political future look like for Clinton's favorite son successor, **Al Gore?** Not that great, although he will almost surely be the Democratic presidential candidate. Gore and his advisors panicked when the reports of fund-raising hanky-panky broke in the news, and it is clear that Gore's "Mr. Clean" image has sullied. Proof of problems is that Gore is having trouble filling staff positions in preparations for his presidential run.

As for Clinton, everybody wondered after the election whether he'd go to the left or to the right. Nobody thought he'd go to sleep. But that's just what he's done. The *NY Times* calls it "a risk-averse, aimless administration." Golf, a new dog, hot tubs, advice to teenagers, long, rambling stories, more fund raising, zzzzzzzz.

* *

Deflation? The argument goes on and on as to whether we're in for inflation, stability, dis-inflation or actual deflation. The final verdict is still not in. The great unknown is how much the Asian deflationary-devaluation collapse will impact on the US. US factory output keeps rising; it's now 4.3% above last year's capacity, which means a greater quantity of domestic goods on top of goods coming in at bargain prices from Asia. (Have you checked the stores lately? Did you ever see so many pre-Christmas sales?) We're moving from a "shop-'til-you-drop" economy to a "save-for-retirement" economy. The word is that huge crowds are wandering around the shopping malls, but not that many are carrying shopping bags. Commodity prices are down, gold is down, bonds are up -- all suggestive of deflation.

NEXT MAILING: Dec. 31, 1997

GOLD, PRECIOUS METALS: I have a real problem with gold. Many of my subscribers have been with me since the '70s and even the late '50s, and they have a "thing" about gold. They remember gold at 800, and they can't get it out of their minds. They simply don't have a realistic view of gold; they think it "belongs" from $500 or $600 up to $1000 an ounce. Maybe it does (I think it does), but my job entails dealing with reality, not with what I wish or what I want.

Gold may be priced at $2000 two years or five years from now, but let's get real -- because if you won't deal with reality in this business, you're going to lose your shirt. Personally, I "think" gold is dirt cheap, but damned if I can predict the bottom. I just hope to **identify** the bottom.

Thirty to forty percent of all gold mines can't make money at today's gold prices. And many mines are now shutting down some production. Furthermore, many central banks are selling gold or talking about selling gold. The latest is Argentina, whose central bank has announced that it has sold most of its gold. Of course, somebody out there is buying all this central bank gold, but we're talking about **price**, not how many central banks will dump their gold and who might be buying. Gold bull markets are a function of sentiment, not simply the condition of the mines.

Gold is now at a 30-year low against stocks, and gold and gold shares often hit their low in the fourth quarter or in December. Silver is another story. Comex stocks of silver are down substantially, and silver inventories are at historic lows. From a July low of 4.25, the March silver futures have surged to 5.85, a rise of 33%. Rising silver is a plus for gold, simply because silver is in the precious metals universe.

One other important fact. Almost every nation (outside of Britain and the US) **will soon be trying to reinflate.** That will mean much more paper. More paper is a **plus** for gold. Gold, the ultimate money, the only money that can't default, is, to my mind, looking "bottomy."

The trend of gold **shares** often precedes the price of gold. So here goes-- I'm showing charts of American Barrick and Placer Dome, along with MACD (I explained MACD earlier). To me, we have the first appearance of a "possible" bottom in gold. Certainly, the sentiment is right for a gold bottom -- everybody and his uncle is bad-mouthing the yellow metal, as notes in this headline story from the December 9 *USA Today*. Gad, this could be the bottom -- there, you (gulp) heard it here first.

COVER STORY

Bullion goes bust as nations weigh precious metal's role

By Thor Valdmanis
USA TODAY

NEW YORK — No crisis, be it financial turmoil sweeping Asia, a sell-off on Wall Street or renewed threats from Saddam Hussein, appears capable of getting a rise out of gold these days.

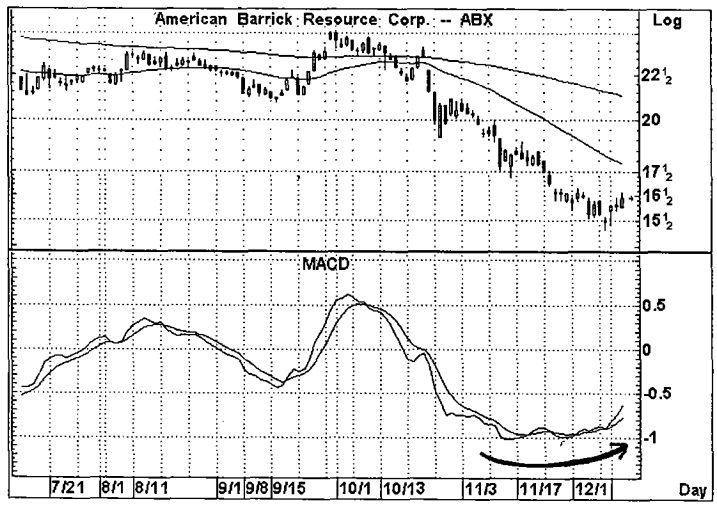
In recent weeks, gold has plunged through the $300 level and now stands at just $287.90 an ounce, its lowest price in 18 years.

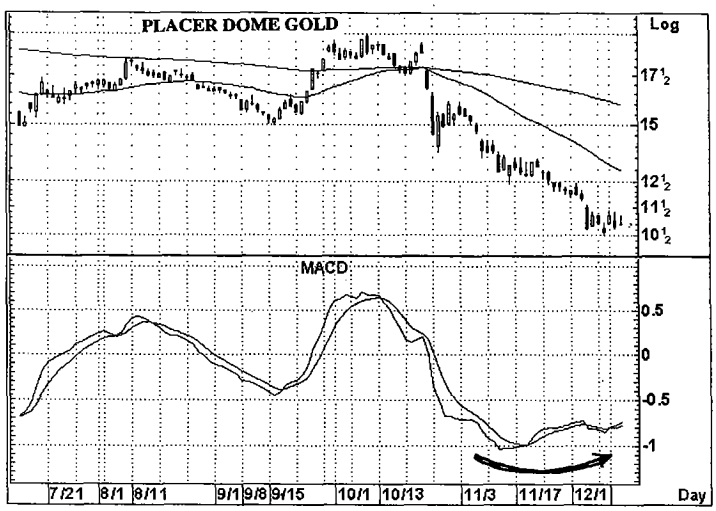
Why is gold's precious-metal tag looking increasingly like an oxymoron?

The most obvious reason is that gold is traditionally a hedge against inflation, and inflation appears all but dead around the world.

Perhaps more ominously for gold, however, is the growing move by central bankers to unload gold reserves and replace them with currencies chunks of gold reserves in favor of paper assets.

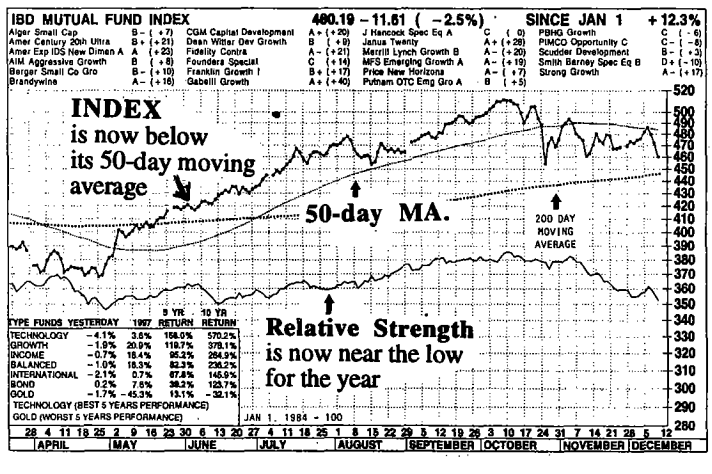
LATE BONDS: I'm not certain why bonds have been so strong. Or I should say I'm not convinced that bonds have been rising strictly on the basis of Asian-generated fear of deflation. It could be that investors and the public are buying bonds because they perceive that US Treasury bonds represent an island of safety in an unsafe world. Or then again (let's make it simple) bonds with yields at 6% look cheap compared with stocks that today offer only micro-yields. Remember my prediction -- the operative word for the rest of the '90s will be **INCOME.**





LATE NOTES: There are a number of items (surprise) that bother me about the stock market. (1) When you buy stocks they better go up, because there's no yield in stocks today -- no income (which is why I believe people are now buying bonds). (2) The Dow Theory says that the market picture is dicey, since a major non-confirmation exists in that the Dow has never confirmed the record Transport highs of October. (3) The advance-decline ratio is lagging badly, as you can see on the page 2 chart. The lagging A-D in the face of declining interest rates is particularly bothersome, since as many as 25% of all NYSE stocks are interest-sensitive and "should" be helped by declining rates.

I'm watching *Investor's Business Daily's* Index of 23 leading growth equity funds. The index looks toppy to me and the funds, since mid-October, have not kept up with the S&P. If the index drops below 450, the fund picture will look less-than-rosy.


IBD MUTUAL FUND INDEX
480.19 – 11.61 (–2.5%)
SINCE JAN 1 +12.3%
INDEX
is now below
its 50-day moving
average
50-day MA.
200 DAY
MOVING
AVERAGE
Relative Strength
is now near the low
for the year
TYPE FUNDS YESTERDAY 1997 RETURN 9 YR 10 YR RETURN
TECHNOLOGY –4.1% 3.6% 188.0% 570.2%
GROWTH –1.9% 20.9% 118.7% 378.1%
INCOME –0.7% 18.4% 95.2% 284.9%
BALANCED –1.0% 16.3% 82.3% 236.2%
INTERNATIONAL –2.1% 0.7% 67.8% 145.9%
BOND 0.2% 7.6% 38.2% 123.7%
GOLD 1.7% –45.3% 13.1% –32.1%
TECHNOLOGY (BEST 5 YEARS PERFORMANCE)
GOLD (WORST 5 YEARS PERFORMANCE)
JAN 1, 1984 = 100
APRIL MAY JUNE JULY AUGUST SEPTEMBER OCTOBER NOVEMBER DECEMBER